

STATE OF NEW YORK

DIVISION OF TAX APPEALS

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In the Matter of the Petition	:	
of	:	
<b>JACK G. SCHWARTZ</b>	:	DETERMINATION
	:	DTA NO. 815708
for Revision of a Determination or for Refund of Sales	:	
and Use Taxes under Articles 28 and 29 of the Tax Law	:	
for the Period December 1, 1994 through May 31, 1995.	:	

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Petitioner, Jack G. Schwartz, 425 East 58th Street, New York, New York 10022, filed a petition for revision of a determination or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period December 1, 1994 through May 31, 1995.

A hearing was held before Jean Corigliano, Administrative Law Judge, at the offices of the Division of Tax Appeals, 500 Federal Street, Troy, New York, on March 19, 1998 at 10:15 A.M., with all briefs to be submitted by September 12, 1998, which date began the six-month period for the issuance of this determination. Petitioner appeared by Alvin Grubman, C.P.A. The Division of Taxation appeared by Steven U. Teitelbaum, Esq. (Vera R. Johnson, Esq., and John E. Mathews, Esq., of counsel).

***ISSUES***

I. Whether, during the assessment period, petitioner was a person responsible for collection and payment of sales taxes on behalf of Gaines Service Leasing Corporation.

II. Whether the absence of a final determination of tax due from Gaines Service Leasing Corporation prevents the Division of Taxation from imposing a sales tax liability on petitioner.

III. Whether petitioner fulfilled his fiduciary responsibility to both New York State and Gaines Service Leasing Corporation by establishing a separate account for sales and use taxes collected by the corporation and turning that account over to the bankruptcy trustee when the corporation filed a Chapter 7 petition in bankruptcy court.

***FINDINGS OF FACT***

1. During the assessment period, petitioner, Jack G. Schwartz, was the sole shareholder and chairman of the board of Gaines Service leasing corporation (“Gaines”). Gaines leased and sold limousines in New York and elsewhere. It was incorporated in 1964 and did business for over 30 years.

2. On February 10, 1995, Gaines filed for reorganization under Chapter 11 of the Bankruptcy Code. Its attempts to reorganize were unsuccessful, and on April 27, 1995, the Chapter 11 petition was converted to a Chapter 7 filing. Alan Nisselson was appointed Chapter 7 trustee shortly after the conversion, and the corporation’s books and records were turned over to him. Gaines transferred funds from its own corporate accounts to the accounts of Nisselson.

3. Around April 1995 the Division of Taxation (“Division”) began an audit of Gaines’s sales tax returns for the period March 1, 1992 through May 31, 1995. The assigned auditor, Frank Jaquez, was not aware of Gaines’s status as a bankrupt when he commenced the audit. According to a contemporaneous log maintained by Mr. Jaquez throughout the audit, he initially contacted Gaines to request the completion of certain electronic processing questionnaires which had been sent to Gaines earlier.

4. On May 3, 1995, Mr. Jaquez visited Gaines’s place of business. Among other things, he wanted to have a consent to extend the period of limitations for assessment of taxes executed

on behalf of Gaines. He learned that Gaines had filed for bankruptcy, and he was given the name of the bankruptcy trustee. The auditor then telephoned Nisselson and mailed him a consent form.

5. Mr. Jaquez telephoned Nisselson on May 5, 1995 and May 16, 1995 to request the return of the consent form. In a telephone conversation that took place on May 16, 1995, Mr. Jaquez “asked for the trustee’s authority to commence the audit of and the release of records of Gaines Service Leasing Corp.” (Auditor’s Log, May 16, 1995, original all in capital letters.) He was told to make contact with the accountant appointed by the court, Mr. Miglino, which he did.

6. On May 19, 1995, the auditor received a consent form signed by Nisselson. On May 24, 1995, the Division mailed a letter to Joseph A. Wagner, then Gaines’s president, scheduling an audit appointment on May 30, 1995. The letter requests that Gaines have all books and records pertaining to its sales tax liability available on the appointment date. Mr. Jaquez also telephoned Mr. Miglino to notify him of the audit appointment.

7. A limited number of records were made available to the auditor at this appointment, including a general ledger for the fiscal year ending September 30, 1994 and trial balances for the periods ending September 1994, May 1995 and June 1995. There were no invoices for fixed asset acquisitions, sales invoices or files of paid bills. The auditor was able to trace reported sales for the quarterly period ending August 31, 1994 to Gaines’s general ledger and he found no tax due for that period. His log for May 30, 1995 states: “Vendor prepared sales tax returns based on preliminary data. Tax adjustments after cut-off are properly reported on the following sales tax return” (original entirely in capital letters).

8. The auditor discussed the audit with Mr. Wagner who was knowledgeable about the business affairs of Gaines. He never spoke directly to petitioner. Mr. Jaquez completed a Responsible Person Questionnaire based upon information provided to him by Mr. Wagner and

Federal income tax returns filed by Gaines for the fiscal years ended September 30, 1992 and September 30, 1993. The questionnaire states that petitioner was not responsible for preparing sales tax returns or ensuring the remittance of tax during the audit period but otherwise had complete authority over the business and financial affairs of Gaines, including the authority: to manage the financial affairs of Gaines; to direct payment to creditors; to sign checks; to negotiate with the Tax Department; to sign legal documents on behalf of Gaines; to hire and fire employees; and to negotiate business loans. According to that questionnaire, petitioner devoted 90 percent of his time to Gaines. The Federal income tax returns show that petitioner was an officer of Gaines and devoted 90 percent of his time to the business in 1992 and 1993.

9. Gaines maintained a sales tax accrual account which the auditor relied on to determine sales tax due from Gaines for the assessment period. In his log entry of July 5, 1995, the auditor refers to this account as the sales tax payable account. He states that as of June 30, 1995, the trial balances posted to this account showed a net sales tax due of \$92,646.09. The documents to which he was referring were computer generated work papers prepared by the Gaines bankruptcy trustee. Those work papers show sales tax collected during the assessment period as follows:

Month	Tax Collected
December 1994	\$ 66,501.75
January 1995	49,949.47
February 1995	26,895.08
March 1995	9,650.68
April 1995	13.50
May 1995	108.00

10. Apparently, the tax was paid to the State for the month of December 1994. The taxes collected for that month were not included in the auditor's calculation of taxes owed by Gaines. Tax was determined to be due for the remaining five months. In addition, the auditor discovered

tax due in the amount of \$338.90 under section 1160 of the Tax Law, known as the special tax on passenger car rentals.

11. During the months of July and August 1995, the auditor continued in his attempts to obtain books and records from the bankruptcy trustee and the appointed accountant. However, those books and records were not made available. The auditor then determined to issue an assessment on the basis of the books and records made available to him.

12. On August 24, 1995, the Division issued to Gaines Service Leasing Corporation a Statement of Proposed Audit Adjustment for the period March 1, 1992 through May 31, 1995. The statement proposed sales tax due of \$82,752.41 for the period December 1, 1994 through February 28, 1995 and sales tax due of \$9,554.78 for the period March 1, 1995 through May 31, 1995. Penalties and interest were also proposed upon the taxes due. On the same date, the Division issued a statement of proposed audit adjustment proposing a special tax due of \$338.90. No taxes were found to be due for the period March 1, 1992 through November 30, 1994. The statements of audit adjustment were mailed to Gaines at its business address.

13. On August 25, 1995, the auditor finalized his audit report, prepared assessment documents and sent information regarding the audit to the Division's Bankruptcy Unit.

14. On or about September 7, 1995, the auditor mailed a copy of the statements of audit adjustment, with worksheets, to Nisselson.

15. On January 26, 1996, the Division issued to petitioner a Notice of Determination of sales and use taxes due for the period December 1, 1994 through May 31, 1995, assessing tax due of \$92,307.19, plus interest of \$9,721.07 and penalty of \$18,174.73 for a total amount due of \$120,202.99. On the same date, it issued a Notice of Determination to petitioner, assessing special tax due of \$338.90 plus interest of 29.67 and penalty of \$200.00. The notices state that

they were issued because petitioner had been found to be liable for sales and use taxes as an officer, or a responsible person, of Gaines Service Leasing Corporation.

16. On January 3, 1997, the Division issued a Conciliation Order to petitioner sustaining both notices in full. Petitioner then filed a petition with the Division of Tax Appeals where he contested the full balance of tax, penalty and interest due as shown on the two notices of determination.

17. A bank statement analysis provided to the Division by Nisselson shows that Gaines maintained a separate account for sales tax with a balance of \$85,750.00 at the time the document was prepared. The date of preparation is not known.

18. A Bank America transfer application was annexed to the petition which was entered into evidence. It shows a transfer of \$133,596.50 from a Gaines account denominated "Special Fund - Tax," account number 0790656167-72, to Alan Nisselson, trustee for Gaines, account number 15816-26550.

19. Although the Division's bankruptcy unit was advised of the audit results, there is no evidence that the Division filed a proof of claim or issued an assessment to Gaines before the bar date established by the bankruptcy court.

20. According to a docket for the Gaines bankruptcy estate, Nisselson applied for and received approval from the bankruptcy court to settle claims made by various Gaines creditors. The Gaines bankruptcy proceeding remained active until at least September 1997. Petitioner claims that over \$300,000.00 remains in trust accounts, but he presented no evidence of that fact.

### ***SUMMARY OF THE POSITIONS OF THE PARTIES***

21. Petitioner raises three issues in this proceeding.

(a) First, petitioner claims that his liability for sales tax is derivative of Gaines's liability. Based on this contention, petitioner claims that it was incumbent upon the Division to have the amount of sales tax due from Gaines approved or determined by the bankruptcy court. Since there is no evidence that the Division filed a proof of claim with the court, there can be no determination of petitioner's derivative liability. Petitioner notes that the audit report indicates that all amounts determined to be due represent post-petition taxes for which the Division could have filed an administrative or priority claim.<sup>1</sup>

(b) Petitioner next claims that during the assessment period he was not a person required to collect tax on behalf of Gaines. He argues that the only evidence indicating his status as a responsible person is based on information provided to the Division by Joseph Wagner. Petitioner points out that he did not sign sales tax returns after 1991 and that there is no evidence that he actually performed any of the acts or duties associated with responsible person status. In addition, petitioner claims that after the Chapter 11 filing, he no longer had any authority to pay over sales tax to the State. He notes that during the period from the initial Chapter 11 filing to the conversion date, Gaines maintained a special tax account and placed funds in that account to insure payment of all taxes including sales taxes. After the conversion, these funds amounted to \$133,596.50.

(c) Finally, petitioner argues that he fulfilled his fiduciary duties to Gaines and to the State by establishing a tax account and turning it over to Gaines, along with other assets. Petitioner asserts that Gaines could not pay pre-petition sales taxes after the Chapter 11 petition was filed without court approval. Because of the short duration of time between the Chapter 11 filing and

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<sup>1</sup>In actuality, it appears that most of the tax assessment constitutes pre-petition debt because the liability for the taxes arose before Gaines filed either Chapter 11 or Chapter 7 petitions, i.e., before February 10, 1995.

the Chapter 7 conversion, petitioner maintains that he did not have the ability to obtain the court's permission to pay the sales taxes before the conversion. After the conversion, petitioner had no authority to pay the taxes over to the State. Petitioner claims that it is unconscionable for the Division to proceed against him personally without attempting to collect sales taxes due through the procedures of the bankruptcy court, especially since trust funds were specifically segregated for payment of taxes at the time Gaines's assets were transferred to the trustee. Petitioner asks that emphasis be given to the fact that creditors were paid under the liquidation plan and that the trustee still holds sufficient assets to satisfy the Division's claim.

### ***CONCLUSIONS OF LAW***

A. Petitioner's claim that his personal liability for sales taxes is derivative of Gaines's liability is contrary to established law. Tax Law § 1133(a) provides, in pertinent part, that every person who is required to collect the tax imposed by article 28 of the Tax Law is personally liable for that tax. In *Matter of Yellin v. New York State Tax Commn.* (81 AD2d 196, 440 NYS2d 382), the court held that a penalty assessed against a corporation's president for willful failure to account for and pay over withholding taxes was separate and independent from the corporation's liability for the unpaid taxes, such that the corporation's discharge of the tax debt under a bankruptcy court's order did not preclude the Division from collecting the penalty from the corporate president. The same result has been reached by the Tax Appeals Tribunal construing Tax Law §§ 1131(a) and 1138 of Article 28. In a sales tax case involving a bankrupt corporation, the Tribunal applied *Yellin's* holding that a corporate officer was not absolved of personal liability "by virtue of the corporation's bankruptcy." The Tribunal stated: "the general rule is that the liability of a responsible officer is separate and independent from that of the corporation" (*Matter of Kadish*, Tax Appeals Tribunal, November 15, 1990). In *Matter of Mustafa* (Tax



Appeals Tribunal, December 17, 1991), the Tribunal held that section 1138(a)(3)(B) of the Tax Law clearly distinguishes the liability of the corporation assessed pursuant to section 1138(a)(1) of the Tax Law from that of its responsible officers. Based upon this analysis of the statute and of the existing case law, the Tribunal held that the cancellation, upon procedural grounds, of a notice of determination issued to the corporation did not prevent the Division from seeking to impose personal liability for sales tax due upon the corporate officer. In *Matter of On-Site Petroleum Unlimited* (Tax Appeals Tribunal, February 8, 1996) and *Matter of Bleistein* (Tax Appeals Tribunal, July 27, 1995), the Tax Appeals Tribunal held that consents to extend the statute of limitation signed on behalf of a corporation are not sufficient to extend the statute for the individual officers. In each case, the Tribunal found that to bind the officers with a consent signed on behalf of the corporation would be inconsistent with settled law that the liability of an officer is separate and independent from that of the corporation. Accordingly, arguments made by petitioner premised on the claim that his liability for sales tax is derivative of Gaines's liability must be rejected.

B. Once a notice of determination is issued, the burden of proof is on petitioner to demonstrate that the basis for assessment is unreasonable or that the amount of tax assessed is incorrect (*Matter of Micheli Contracting Corp. v. New York State Tax Commn.*, 109 AD2d 957, 486 NYS2d 448). Petitioner argues that the Division's conclusions regarding his status as a person responsible for collection of sales tax is based entirely on hearsay information offered by Mr. Wagner and that there is no evidence in the record that petitioner ever performed the duties of a responsible officer. Inasmuch as the burden of proof was on petitioner to show that the notices of determination issued to him were incorrect, it was incumbent upon him to present evidence to show that he was not a person responsible for collection of sales tax. He failed to

offer evidence to rebut the Division's conclusion, thus he submitted to the presumed correctness of the statutory notice (*Matter of Hygrade Casket Corporation*, Tax Appeals Tribunal, December 16, 1993).<sup>2</sup>

C. Finally, petitioner argues that he fulfilled his fiduciary duty by turning the tax account over to the trustee and that it was incumbent on the Division to collect the sales tax in the Gaines bankruptcy proceeding. As a preliminary, I reject the Division's claim that petitioner failed to prove that the tax account was turned over to the trustee. The Bank America transfer application and the trustee's bank statement analysis establish that funds earmarked for the payment of tax were turned over to the trustee. At least \$85,750.00 of that money was initially categorized by the trustee as earmarked for sales tax. I also reject the Division's contention that petitioner was a person responsible for collection and payment of tax due through the end of May 1995. It is undisputed that the Chapter 7 filing was made on April 27, 1995. From that point, Gaines was in the control of the bankruptcy trustee, Alan Nisselson, and petitioner cannot be held to be responsible for collecting and paying over sales tax after that date (*see, Matter of Kadish, supra*). The sales tax return for the period ending May 31, 1995 was due to be filed on June 20, 1995 (Tax Law § 1136[b]); therefore, the duty to file that return was with Nisselson and not with petitioner. Accordingly, tax assessed for the period March 1, 1995 through May 31, 1995 in the amount of \$9,554.19 (L-011666654) and the special tax on passenger car rentals assessed for the same period in the amount of \$217.40 (L-011666655-9) shall be cancelled.

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<sup>2</sup>Petitioner's reliance on *Stacy v. State of New York* (82 Misc 2d 181, 368 NYS2d 448) is far wide of the mark. In a declaratory judgement action, the State Supreme Court held that pursuant to the holding in *Matter of Parsons v. State Tax Commn.* (34 NY2d 190, 356 NYS2d 593) section 1138 of the Tax Law had no applicability when returns were filed and the computation of the tax liability was not disputed. The *Parsons* decision effectively prevented the Division from using the administrative procedures provided for in Tax Law § 1138 to collect tax from a responsible officer or person where a correct tax return was filed by the business entity — not the case here. The Tax Law has since been amended to allow the Division to move for collection of tax through an administrative proceeding whether a correct return has been filed or not (Tax Law § 1138[a][3][B]).

D. With respect to the period December 1, 1994 through February 28, 1995, petitioner has presented no evidence to show that he was prevented from filing a sales tax return for this period or paying over the taxes due to the State. The facts offered by petitioner in this proceeding were few, and those that exist do not support his claim that he could not lawfully file a sales tax return and pay the tax due after Gaines filed a Chapter 11 petition. The record shows that petitioner was the chairman of the board and sole stockholder of Gaines under a legal duty to collect sales tax and pay the tax over to the State. Apparently, Gaines was the debtor-in-possession after the Chapter 11 filing in February 1995, and there is no evidence that petitioner was legally precluded from filing sales tax returns while Gaines was operating under a Chapter 11 reorganization.

Petitioner argues that the position taken by the Division is unfair. Gaines collected sales tax from its customers and deposited the tax in a sales tax accrual account where it was held in trust for the benefit of the State. In petitioner's view, Gaines acted properly in holding the monies until the Chapter 7 filing and then turning them over to the bankruptcy trustee, earmarked for payment of sales tax. Petitioner argues that he fulfilled his fiduciary responsibilities with these actions and that it is inequitable to penalize him for the Division's failure to file a timely bankruptcy claim. In truth, it is difficult to understand why a bankruptcy claim was not timely filed (if it was not) when the Division was well-informed of the fact of Gaines's bankruptcy filings. The auditor had actual contact with Nisselson and the bankrupt's accountant, obtained a consent to extend the assessment period from Nisselson, sought and received books and records from Nisselson and forwarded statements of proposed audit adjustment to Nisselson and to the Division's own bankruptcy unit. In fact, there was evidence that the audit was expedited in order to enable the Division to make a timely claim for payment. Under these circumstances, petitioner's claim of unfairness has some resonance. Nonetheless, there are no provisions of the

Tax Law or principles of equitable estoppel which prevent the Division from imposing personal liability on petitioner for the taxes due (*see, Matter of Binder*, Tax Appeals Tribunal, August 13, 1993; *Matter of Rashbaum*, Tax Appeals Tribunal, December 15, 1994). Accordingly, tax assessed for the period December 1, 1994 through February 28, 1995 is sustained.

E. The petition of Jack G. Schwartz is granted to the extent indicated in Conclusion of Law “D”; the notices of determination issued on January 26, 1996 shall be modified accordingly; and in all other respects, the notices are sustained.

DATED: Troy, New York  
December 31, 1998

/s/ Jean Corigliano  
ADMINISTRATIVE LAW JUDGE